FOR ARGUMENT.

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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

—*v.*—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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PRELIMINARY STATEMENT

The arguments set forth in the separate briefs of the Trustee and SIPC[1] to support the erroneous decision of the Court of Appeals majority simply do not accord with the language, structure and purposes of the 1934 Act, with the legislative history, or with the controlling authorities. Those arguments—which are a hodgepodge of overbroad generalizations about the purported role of the judiciary in effectuating Congressional purposes, erroneous assump-

[1] As used herein, "Tr. Br." refers to the Trustee's brief, "SIPC Br." to SIPC's brief, and "T. R. Br." to Touche Ross' main brief.

tions and assertions concerning the statutory meaning and legislative intent, and misstated and misapplied authorities—would have this Court ignore the express provisions of a comprehensive statutory and regulatory scheme established by Congress over more than forty years, and to create judicially for the purported benefit of brokerage firm customers a different set of duties and remedies that Congress itself never thought necessary and chose not to adopt.

The arguments of the Trustee and SIPC must also be considered in light of the fact that, for all their talk about protecting the rights of brokerage firm customers, the real beneficiary of the new duties and remedies that they would have this Court create is not the customers at all, but rather SIPC itself. The underlying premise of the arguments of the Trustee and SIPC is that brokerage firm customers are the "especial beneficiaries" of Section 17(a) and that an implied private right of action therefore should be created for the protection of those customers. While it is demonstrated hereinafter that that premise is erroneous, in any event neither the Trustee nor SIPC is such a customer, and both the Trustee and SIPC admit that ordinarily the only plaintiff capable of asserting any substantial Section 17(a) claims in a case of this sort is SIPC itself (especially since SIPC coverage for customer losses was increased by the 1978 amendments to SIPA), rather than any customer (Tr. Br. 48-49; SIPC Br. 55). In other words, the implication of a Section 17(a) remedy would not benefit the customers, but instead would benefit the entity (SIPC) that Congress created to provide financial protection to the customers, by permitting that entity to avoid the costs of providing that protection.

ARGUMENT

I

The Trustee And SIPC Err In Arguing That Section 17(a) Creates An Implied Private Right Of Action For Damages For Misstatements In Section 17(a) Reports

The Trustee and SIPC argue that the express remedy provided in Section 18(a) for misstatements in reports required by the 1934 Act is "not pertinent" to Section 17(a) reports, and therefore *National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers ("Amtrak")*, 414 U.S. 453 (1974), *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), are inapplicable here; that Section 27 of the 1934 Act and the "statutory tort" doctrine require implication of a private right of action for violation of Section 17(a) because brokerage firm customers are the "especial beneficiaries" thereof; that such an implied private right of action is "necessary"; and that the criteria articulated in *Cort* v. *Ash*, 422 U.S. 66 (1975), are satisfied.

However, as demonstrated hereinafter, those arguments are erroneous and must be rejected. Section 18(a) plainly is applicable to Section 17(a) reports and reflects a Congressional intent that brokerage firm customers are not to derive substantive legal rights or remedies from the reporting requirements of Section 17(a). Moreover, the language and legislative history of Section 17(a) simply do not support the contention that Congress, in enacting Section 17(a), was particularly concerned with such customers, as distinguished from the purchasers and sellers referred to in Section 18(a), or that it intended Section 17(a) for the "especial benefit" of the customers.

Consequently, *Amtrak, Barbour* and *Blue Chip Stamps* are the controlling decisions, and the Trustee and SIPC err in purporting to distinguish them. They also rely improperly on Section 27 and the "statutory tort" theory, which not only do not provide the appropriate analysis, but also establish requirements that cannot be satisfied here. The Trustee and SIPC further err in arguing that an implied right of action under Section 17(a) is "necessary", because they overlook the many other "protections" already provided for brokerage firm customers, as well as the explicit Congressional recognition in enacting SIPA that there is no federally-created private damage remedy in the 1934 Act for customer losses resulting from brokerage firm failure, and that SIPC (rather than such a private damage remedy) was being created to fill that void; because they overstate the importance of the Section 17(a) reports involved here; and because they misstate the scope of the appropriate state law remedies. Finally, the Trustee and SIPC err in their purported *Cort* v. *Ash* analysis.

A. The Trustee And SIPC Err In Contending That Section 18(a) Is Not Pertinent To Section 17(a), And That *Amtrak, Barbour* And *Blue Chip Stamps* Therefore Are Inapplicable.

1. SECTION 18(a) IS PERTINENT HERE.—The Trustee and SIPC seek to avoid the obviously chilling effect of Section 18(a) on their claim of an implied private right of action under Section 17(a) by asserting the untenable proposition that Section 18(a) is "not pertinent" to Section 17(a) and is not "a material consideration" (Tr. Br. 39; SIPC Br. 21, *see also* 33-37). Their argument is that (i) Section 17(a) and Section 18(a) address "different and separable classes of persons and interests" or different

so-called "spheres" (Tr. Br. 39; SIPC Br. 21); (ii) Section 18(a) is addressed to investors "in their capacity *as traders", i.e.,* to a so-called "transactional sphere" (*id.*), whereas Section 17(a) is addressed to investors "in their capacity *as customers* who must entrust their cash or securities to broker-dealers", *i.e.,* to a so-called "bailment sphere" (Tr. Br. 40; SIPC Br. 21); and (iii) since brokerage firm customers are not "traders" (*i.e.,* purchasers or sellers of securities), Section 18(a) is not pertinent to them and a remedy should be implied for their benefit under Section 17(a) itself. The argument is totally without merit and must be rejected.

The contention of the Trustee and SIPC that Section 18(a) is "not pertinent" to Section 17(a) is so clearly erroneous as to be frivolous. Section 18(a) simply cannot be read as inapplicable to Section 17(a), in light of the express requirement of Section 17(a) that broker-dealers shall "make reports" and the express remedy of Section 18(a) for misleading statements in "any . . . report". That fact is inescapable and is uniformly recognized by the Court of Appeals majority, Judge Mulligan's dissent, the District Court, other decisions and the legislative history (*see* T. R. Br. 36-37).[2]

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[2] SIPC errs in contending that the legislative history of Section 18(a) does not reflect a Congressional understanding that Section 18(a) is applicable to misstatements in Section 17(a) reports (SIPC Br. 34-36). SIPC overlooks the statement of Senator Fletcher that Section 18(a) "imposes civil liability for false or misleading statements in any of the reports or records required under this act" (*see* T. R. Br. 38 n.18). Moreover, with respect to the written statement submitted to both the Senate and House committees by Richard Whitney, President of the New York Stock Exchange, which expressly refers to Section 18(a) liability for misstatements in reports required of "persons transacting business in securities" (*see id.*), Mr. Whitney testified at length concerning his views and was extensively cross-examined. *See Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before the Senate Comm. on Banking & Currency,* 73d Cong., 2d Sess. 6582, 6600, 6657, 6709, 6779, 6844, 6870, 7211 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the*

It is also specious for the Trustee and SIPC to contend that the purpose of Section 18(a) simply is "to define the elements of a cause of action for . . . . *traders* [*i.e.*, purchasers and sellers] in the stock of listed corporations" (Tr. Br. 39; *see also* SIPC Br. 33). Section 18 is entitled "Liability for Misleading Statements" (instead of, for example, "Rights of Traders" or "Rights of Purchasers and Sellers"), thereby plainly demonstrating that the Congressional intention in Section 18(a) was not simply to define the rights of so-called "traders", but to delineate the full scope of liability for misstatements in required reports.[3] By omitting from Section 18(a) any substantive rights for brokerage firm customers who are unable to satisfy the purchaser-seller requirement, Congress demonstrated an intention that customers are to derive no "legal rights" from the reporting provisions of Section 17(a).

The basic premise of the Trustee and SIPC that in enacting Section 17(a) Congress intended to protect investors in their role as "customers" as distinguished from investors in their role as so-called "traders", and thus to deal with a so-called "bailment sphere" as distinguished

House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 151, 178, 213, 287, 723 (1934). Consequently, SIPC does not advance its contention by noting the reference in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 31 (1977), to the "limited value" of "written statements received *without comment by the committee and without cross-examination*" (emphasis added) (*see* SIPC Br. 34). *Cf. Amtrak, supra*, 414 U.S. at 459-460 (weight given to letter sent by Secretary of Transportation to subcommittee chairman).

[3] That Congress always understood Section 18(a) to be applicable to reports filed by broker-dealers concerning their financial condition, and not only to reports of corporate issuers of securities (as is contended at SIPC Br. 35), is evidenced by the fact that when Congress enacted Section 8 of SIPA, 15 U.S.C. § 78hhh (1970), requiring broker-dealers to file reports of their financial condition and other matters for purposes of computing SIPC assessments, it saw a need for expressly exempting those reports (which are not the reports here involved) from the scope of Section 18(a).

from a so-called "transactional sphere", is an imaginary construct that has never been urged or accepted anywhere before, and is both totally unsupported by any authority and contradicted by the pertinent legislative history. Nothing in the language of Section 17(a), or in any decision, suggests the distinction urged by the Trustee and SIPC, and the attempt of the Trustee and SIPC arbitrarily to compartmentalize the reporting provisions of the 1934 Act into different purported "spheres" conflicts with the fact that many of the reporting provisions are intended for the benefit of various different types of investors, *see, e.g.*, *GAF Corp.* v. *Milstein*, 453 F.2d 709, 713 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972) (Section 13(d)), yet only purchasers and sellers have any remedy for misleading statements in such reports (*see* T. R. Br. 51-54). Moreover, the meager citations to the legislative history of the 1934 Act upon which the Trustee and SIPC rely (*see* Tr. Br. 6, 29) neither refer to Section 17(a) specifically nor support the premise that Congress enacted Section 17(a) for the especial benefit of brokerage firm customers, as opposed to purchasers and sellers. The portion of the House report cited by the Trustee and SIPC simply discusses, without mentioning Section 17(a), the evils of unnecessary, unwise and destructive speculation in stocks that resulted in "mad booms and terrible depressions". H.R. REP. NO. 1383, 73d Cong., 2d Sess. 3 (1934). Similarly, the portion of the Senate report cited by the Trustee and SIPC does not refer to Section 17(a) and relates only to the dangers resulting from an "undue volume of brokers' loans" that provided "excessive credit for speculation" and imperiled margin *traders* and the banking system. S. REP. NO. 1455, 73d Cong., 2d Sess. 12-15 (1934). Significantly, the Trustee and SIPC omit any reference to another Senate report that, in discussing the actual Congressional intention in enacting Section

17(a), mentions only the need for brokers to maintain "adequate records of transactions" so the SEC would be "able to obtain evidence rapidly in any case where *fluctuations in the price of a security indicate that manipulation may be in progress*" (emphasis added), and that thereby makes clear Congress' concern underlying Section 17(a) to protect not brokerage firm customers (as the Trustee and SIPC argue), but rather the very purchasers and sellers (to whom the Trustee and SIPC refer as "traders" in the "transactional sphere") who concededly are the beneficiaries of the express remedy of Section 18(a).[4] S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934).[5]

[4] Although Congress' express concern in enacting Section 17(a) clearly was not the protection of brokerage firm customers, the SEC has relied since 1942 on the rule-making authority provided by Section 17(a) to require broker-dealer reports that are intended, at least in part, to improve safeguards afforded to such customers. However, even in that respect, the primary purpose of the Section 17(a) reports has been to provide one element of a reporting and monitoring system that attempts to prevent brokerage firm insolvencies, and not to provide any scheme of private damage remedies for recovery of losses after insolvency has occurred (*see* T. R. Br. 21-23, 60-64).

[5] Even if it were assumed, as the Trustee and SIPC contend, that Section 17(a) is concerned uniquely with the protection of customers, that Section 18(a) does not and was not intended to deal with that concern, and that there is only a "merely theoretical" possibility that the Section 18(a) remedy will be available for misleading statements in Section 17(a) reports (SIPC Br. 33; *cf.* Tr. Br. 40; *but see* T. R. Br. 36 n.17, 64 n.39), Section 18(a) nevertheless still is pertinent. The fact that Congress *contemporaneously* provided in Section 18(a) a remedy to purchasers and sellers for misleading reports, but failed to provide therein any similar remedy to customers, demonstrates that Congress did not intend that the customers have a damage remedy (*see* T. R. Brief 57-58). *See T. I. M. E., Inc.* v. *United States,* 359 U.S. 464 (1959) (the enactment of an express remedy with regard to certain provisions of a statute requires an inference that the omission of a similar remedy for other comparable provisions was intentional); *cf. Cort* v. *Ash,* 422 U.S. 66, 82-83 n.14 (1975) (such an inference is not required where, unlike the situation here, the statutory provision under which a remedy is sought to be implied is "of much earlier origin" than the statutory provisions for which an express remedy is provided).

2. *Amtrak* AND *Barbour* ARE CONTROLLING DECISIONS HERE.—The Trustee and SIPC argue that Section 18(a) is "not pertinent" to Section 17(a) reports as part of their attempt to distinguish away this Court's otherwise clearly controlling decisions in *Amtrak* and *Securities Investor Protection Corp.* v. *Barbour, supra* (*see* SIPC Br. 37-41; Tr. Br. 42-45). Of course, since Section 18(a) is so clearly applicable to Section 17(a) reports, and since the Trustee and SIPC err in arguing to the contrary, their purported basis for distinguishing *Amtrak* and *Barbour* simply does not exist. As another part of their attempt to fabricate a distinction, the Trustee and SIPC talk at length about their unsupported assumptions concerning "evident legislative intent" and the "overall legislative scheme", but in so doing they overlook the central teaching of both *Amtrak* and *Barbour.* Those decisions recognize that Congressional enactment of a limited express remedy for violation of a particular statutory provision is probative and compelling evidence of a legislative intent to preclude a broader implied remedy; that such evidence derived from the statutory structure is determinative (under the doctrine, *expressio unius est exclusio alterius*) in the absence of "clear contrary evidence" of legislative intent; and that to imply such a broader implied remedy absent the requisite "clear contrary evidence" would be inconsistent with the legislative scheme (*see* T. R. Br. 40-43). In addition, as in *Amtrak* and *Barbour,* acceptance of the theory urged by the Trustee and SIPC would undermine the statutory purposes.

The Trustee and SIPC err in arguing that the "clear contrary evidence of legislative intent" requirement of *Amtrak* and *Barbour* "conflicts" with the statement in *Cort* v. *Ash, supra,* 422 U.S. at 82, that where "it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private right of action, although an explicit purpose to *deny* such

cause of action would be controlling" (*see* SIPC Br. 40-41). That statement was addressed to a situation where (unlike *Amtrak*, which *Cort* v. *Ash* expressly distinguished, and *Barbour*) no express remedy whatsoever was provided for violation of the pertinent statutory provision and therefore nothing in the statutory structure itself reflected an intention to deny an implied remedy. This point is emphasized in *Barbour* where, even though the "primary [Congressional] purpose" in enacting SIPA was "the protection of investors", this Court, in refusing to imply a remedy for such investors, did not require an affirmative showing from the legislative history of a Congressional intention to deny an implied right of action and no such legislative history was cited. Instead, *Barbour* simply reiterated the "clear contrary evidence" requirement of *Amtrak* (*i.e.*, the requirement of explicit evidence of Congressional intention to *create* an implied right of action) and found that it was not satisfied because "there is no extrinsic evidence that Congress intended to allow [such] an action". 421 U.S. at 419-421.

The Trustee and SIPC also would distinguish *Amtrak* and *Barbour* on the purported ground that, although the particular plaintiffs there concededly were denied the remedies they sought, the "protected classes" in general were not denied protection since enforcement still could be sought by the Attorney General (*Amtrak*) and the SEC (*Barbour*), whereas here denial of an implied Section 17(a) remedy purportedly would be inconsistent with the legislative intent because it "would leave the intended beneficiaries of the statute without a remedy for wrongs the statute was designed to protect against" (SIPC Br. 39-40). However, even assuming that Congress did enact Section 17(a) to protect brokerage firm customers (which it did not, *see* pp. 6-8, *supra*), the purported distinction is

unpersuasive. The refusal to imply a Section 17(a) remedy will not deprive customers generally of protection, for they already have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), both as part of the monitoring system and as a source of funds to pay customer losses, the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies (*see* T. R. Br. 56, 60-63; *see also* pp. 24-28, *infra*, concerning the lack of "necessity" for an implied right in light of such existing protections). Those "protections", rather than any implied private right of action for damages under Section 17(a), are comparable to the means of protection found to have been intended by Congress in *Amtrak* and *Barbour*. *See also* S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934) (in subdivision entitled "Administrative Machinery", dealing with the SEC's authority to take "disciplinary action short of criminal or civil penalties", Section 17 discussed as a means to provide the SEC with information to enable it to fulfill its "responsibility for investigating violations of the act").

In enacting SIPA in 1970, Congress explicitly recognized the existence of such "protections" for brokerage firm customers. *See* H.R. REP. NO. 91-1613, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5256 ("There are some safeguards, however, on both the State and Federal levels as well as in industry imposed regulations"); *Hearings Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, Security Investor Protection,* 91st Cong., 2d Sess. 150 (1970) (statement of SEC chairman Hamer H. Budge). Moreover, in creating SIPC to provide funds to pay customer losses, Congress explicitly stated its understanding that no federally-created private damage remedy under any section of the 1934 Act (*e.g.*, Section

17(a)) was available to compensate against such losses. As the Senate report on SIPA pointed out,

> "Apart from the voluntary trust funds, *there is no protection presently available under existing securities laws for the investor whose broker goes bankrupt.* The Securities Act of 1933 requires that investors have adequate information to exercise sound judgment concerning the securities they purchase; and the Securities Exchange Act of 1934 insures that they will not be victimized by fraudulent, manipulative, or deceptive selling schemes. But *neither statute prevents the investor from losing his entire investment if his broker fails* because of operational and, ultimately, financial difficulties" (emphasis added). S. REP. NO. 91-1218, 91st Cong., 2d Sess. 3 (1970).

Therefore, to the extent that it considered existing "protections" for customers to be inadequate, *see* H.R. REP. NO. 91-1613, *supra,* at 5256, Congress clearly "believed that it was filling a regulatory void" when it enacted SIPA and created SIPC (instead of a private damage remedy) to provide the additional financial protection to customers it believed necessary (*see* T. R. Br. 62 n.37). *International Brotherhood of Teamsters* v. *Daniel,* 99 S. Ct. 790, 802 (1979). *See* 116 CONG. REC. 40867 (1970) ("there still exists *a serious gap* in our securities laws which neither of [the 1933 Act and the 1934 Act] covers" (emphasis added)) (remarks of Sen. Muskie).

Implication here of a private right of action under Section 17(a) would create the serious potential for undermining significant statutory purposes, an effect held to be unacceptable in *Amtrak* and *Barbour.* One of the important purposes of SIPA was to impose upon SIPC, the SEC and the self-regulatory organizations such as the stock exchanges the duty of insuring the financial responsi-

bility of brokerage firms. For example, Section 9 of SIPA provides that "[t]he self-regulatory organization of which a member of SIPC is a member shall inspect or examine such member for compliance with applicable financial responsibility rules", and that "SIPC shall consult and cooperate with the self-regulatory organizations toward the end . . . that . . . examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards". 15 U.S.C. §§78iii(c), 78iii(e) (1970). *See also* Section 6 of the 1934 Act, 15 U.S.C. §78f (each national securities exchange is "to enforce so far as within its powers compliance by its members, with the provisions of [the 1934 Act]"). And in *Barbour,* this Court pointed out that

> "Congress enacted the SIPA to . . . restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers . . . . *The Act apportions responsibility for these tasks among the SEC, the securities industry self-regulatory organizations, and the SIPC.* . . . Congress imposed upon the SEC, the exchanges, and the self-regulatory organizations the obligation to report to the SIPC any situation that might call for its intervention" (emphasis added). 421 U.S. at 415-416, 425.

Of course, in that apportionment of responsibility, there is no mention of any role for, or duties imposed upon, independent accountants such as Touche Ross. However, the Trustee and SIPC, in arguing for the implication of a private right of action under Section 17(a), nevertheless assume the existence of just such a role and such duties, and proceed from there to magnify the responsibilities (and the concomitant risks and exposure to liability)

allegedly implicitly imposed upon accountants, and to minimize accordingly the responsibilities explicitly imposed upon the regulatory authorities such as SIPC. Thus, the thrust of the argument by the Trustee and SIPC is that the legislative scheme contemplates that the SEC, SIPC and the self-regulatory organizations are not themselves to perform virtually all of the inspection and monitoring duties statutorily imposed upon them, and that such duties are to be transferred by judicial implication to the accountants who are retained by a brokerage firm (*see* Tr. Br. 18-19, 33-35), an argument exemplified by SIPC's blatantly absurd assertion that the once-yearly "certifications [by accountants] of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule" (SIPC Br. 16).[6]

It would undermine the statutory purposes, and only encourage lack of diligence on the part of the regulatory authorities, to accept the view of the Trustee and SIPC that the once-a-year audits of brokerage firms are the *only* means to enforce financial responsibility rules, and that accountants therefore must be deemed responsible for all subsequent consequences of undetected weaknesses (*see also* T. R. Br. 74, 105). In this case, the regulatory authorities, obviously embarrassed by the failure of whatever inspection and monitoring they performed (or should have performed) to detect the illicit practices in which Weis engaged throughout virtually its entire 1973 fiscal year, seek a scapegoat and attempt to place all the blame on Touche Ross because of its failure to detect the alleged incipiency of such practices at the end of Weis' 1972 fiscal year (*see* A. 9 [¶12], A. 19-A. 21[¶31]). If Touche Ross

[6] The fact that the Trustee and SIPC overstate the importance of the once-a-year audits, and that the "early warning system" involves much more than those audits, is discussed at pp. 26-27, *infra*.

is to be held responsible for the fact that the regulatory authorities were unable properly to supervise Weis during an entire year subsequent to the audit, it is apparent that in future situations the regulatory authorities will feel no compelling need to be diligent or aggressive in their continuing responsibility to inspect broker-dealers, knowing that if any problems arise, they need only to blame the accountants for failing to discover on their previous once-a-year audit the alleged weaknesses that purportedly permitted the problems later to develop. At bottom, then, the theory of the Trustee and SIPC is that, despite Congress's express allocation of continuing duties to the regulatory authorities (including SIPC's duty ultimately to pay customer losses), they should be permitted to pass on those duties to accountants who agree to perform a once-a-year audit of a brokerage firm's Section 17(a) reports.[7] That result would be totally inconsistent with the statutory purposes.

3. *Blue Chip Stamps* ALSO CONTROLS HERE.—The Trustee and SIPC also improperly attempt to distinguish *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which applied in the specific context of the 1934 Act the principle, recognized in *Amtrak* and *Barbour,* that it is improper to imply a remedy for a statutory violation that would be broader than the express remedy already provided in

[7] *Cf. Securities & Exchange Commission* v. *Arthur Young & Co.*, ___F.2d ___, [Current Binder] FED. SEC. L. REP. (CCH) ¶96,766 at 95,006-95,007 (9th Cir. Feb. 1, 1979)("To accept the SEC's position would go far toward making the accountant both an insurer of his client's honesty and an enforcement arm of the SEC. We can understand why the SEC wishes to so conscript accountants. Its frequently late arrival on the scene of fraud and violations of securities laws almost always suggests that had it been there earlier *with the accountant* it would have caught the scent of wrongdoing and, after an unrelenting hunt, bagged the game. What it cannot do, the thought goes, the accountant can and should. The difficulty with this is that Congress has not enacted the conscription bill that the SEC seeks to have us fashion and fix as an interpretive gloss on existing securities laws.")

the statute (SIPC Br. 41-42). They misconstrue, and therefore misapply here, this Court's statement in *Blue Chip Stamps* that it would be "anomalous" to expand the plaintiff class for a judicially implied cause of action beyond the bounds delineated by Congress "for *comparable* express causes of action" (emphasis added by SIPC). *Blue Chip Stamps* did not, as they circularly argue, find Sections 10(b) and 18(a) of the 1934 Act to be "comparable" because both were intended to provide remedies only to purchasers or sellers, for the very issue to be decided in *Blue Chip Stamps* was whether Section 10(b) did apply only to purchasers or sellers. Rather, Sections 10(b) and 18(a) were found to be "comparable" because they dealt with similar subject matter, and that finding was the premise for the Court's conclusion that the express purchaser-seller requirement of Section 18(a) must also apply to implied rights of action under Section 10(b). To imply a right of action under Section 17(a) broader than the express remedy under Section 18(a) would be even *more* "anomalous" than to imply such a broader right under Section 10(b). The express Section 18(a) remedy deals not with circumstances which are simply "comparable" to those dealt with by Section 17(a); it deals with precisely the same circumstances, *viz.*, misstatements in reports required to be filed under Section 17(a). Consequently, the *Blue Chip Stamps* principle is not distinguishable and precludes any implied private right of action under Section 17(a).

In response to Touche Ross' demonstration that this case involves the type of speculative claim that *Blue Chip Stamps* recognized should be precluded by the purchaser-seller requirement of Section 18(a) (T. R. Br. 48-50), the Trustee and SIPC offer only their own conclusory assertions that it is not so, coupled with the self-serving declaration that neither of them would commence a

"strike" suit (*see* SIPC Br. 42, 54-55; Tr. Br. 45-46). However, their own description of this case as "a private action to recover customer losses that *might have been* avoided by a proper audit" (emphasis added) (Tr. Br. 19) belies their denial that the claim asserted here necessarily is a speculative one. The administrative scheme established by the 1934 Act and SIPA permits the regulatory authorities (including the SEC, SIPC and the stock exchanges) a broad range of *possible* actions in attempting to deal with the problems of a brokerage firm that is in peril of financial collapse, but experience demonstrates the uncertainties involved and that the regulatory authorities will not necessarily succeed in averting a collapse even after timely notice of the peril. *See Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 421-422; *Hughes* v. *Dempsey-Tegeler & Co., Inc.,* 534 F.2d 156, 168-174 (9th Cir.), *cert. denied,* 429 U.S. 826 (1976). There simply is no way that the Trustee and SIPC here (or plaintiffs in any similar case) could offer any proof other than subjective, "uncorroborated oral evidence"—*i.e.,* surmise and conjecture—as to what the regulatory authorities *might* have been able to accomplish had Weis' Section 17(a) reports not been misleading, and their subjective version of what *might* have occurred necessarily would relate to "elements . . . totally unknown and unknowable to the defendant". *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 746.

The Trustee and SIPC also argue that "[t]his Court's decisions under Rule 10b-5 and the Williams Act have never suggested that Section 18 is the exclusive remedy for Exchange Act violations even where, as in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), the filing of a 'report' or 'document' was involved" (Tr. Br. 42), and that *Piper* involved "false statements in a registration statement" (Tr. Br. 21). While the argument is mis-

leading, because a registration statement is a document filed under the 1933 Act, not the 1934 Act, and because *Piper* involved misstatements in a variety of documents (*e.g.*, letters to shareholders and press releases) not filed under either the 1933 Act or the 1934 Act, the argument must also be rejected because of its more basic error. Even if it be assumed that remedies for violations of the *antifraud* and *proxy* provisions (the basic purpose of which is to insure that investors are furnished directly with adequate data in connection with their own investment and corporate voting activities) would not be precluded by Section 18(a) simply because the data also is filed with the SEC,[8] it does not follow that Section 18(a) does not set forth the exclusive remedy intended by Congress for violation of *reporting* provisions, such as Section 17(a) (the basic purpose of which is to provide information to the SEC and regulatory authorities—*see* T. R. Br. 23, 63-64).

B. The Trustee And SIPC Err In Their Reliance On Section 27 Of The 1934 Act And The "Statutory Tort" Theory.

In arguing for an implied right of action under Section 17(a), the Trustee and SIPC rely heavily on the jurisdictional grant in Section 27 of the 1934 Act and the

[8] Several district courts have held that the exclusive remedy in Section 18(a) for misstatements in documents filed with the SEC pursuant to the 1934 Act precludes any implied remedy for such misstatements under Section 10(b) and Rule 10b-5. *See, e.g., Ross* v. *A. H. Robins Co., Inc.*, [Current Binder] FED. SEC. L. REP. (CCH) ¶96,737 (S.D.N.Y. 1979); *Poller* v. *First Virginia Mortgage & Real Estate Investment Trust*, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,564 (E.D. Va. 1978); *Kulchok* v. *Government Employees Ins. Co.*, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,002 (D.D.C. 1977). *Cf. Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 752 n.15, where this Court reserved "the question of whether an implied action under §10(b) of the 1934 Act and Rule 10b-5 will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act".

"statutory tort" theory, which SIPC contends was incorporated into the analysis set forth in *Cort* v. *Ash, supra* (*see* Tr. Br. 25-38; SIPC Br. 20-25, 53). Although SIPC (but not the Trustee) also purports to set forth an analysis based upon *Cort* v. *Ash,* both the Trustee and SIPC appear to rely on Section 27 and the "statutory tort" theory independently of *Cort* v. *Ash.* However, their reliance is misplaced, because it fails to take into account such crucial criteria as (i) consistency of any implied right of action with the evident legislative intent and effectuation of the underlying statutory purposes (recognized in *Amtrak* and *Barbour,* and reiterated in *Cort* v. *Ash*), (ii) the "necessity" for an implied right of action (recognized in *Borak,* reiterated in *Cort* v. *Ash* and emphasized in *Piper*), and (iii) the appropriateness of state law remedies (recognized in *Cort* v. *Ash, supra,* and emphasized in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), and *Piper* v. *Chris-Craft Industries, Inc., supra*). Moreover, Touche Ross does not, as the Trustee puts it (Tr. Br. 20, 39), "virtually concede" that the "statutory tort" theory and the cases purportedly articulating it, even if they were applicable, would require the implication of a private right of action under Section 17(a).

1. SECTION 27 DOES NOT REQUIRE THAT A PRIVATE RIGHT OF ACTION BE IMPLIED UNDER SECTION 17(a).—The Trustee and SIPC erroneously argue that a private right of action must be implied from Section 17(a) because Section 27 of the 1934 Act generally grants to the federal courts jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created" under the 1934 Act. 15 U.S.C. §78aa. Even the cases most heavily relied upon by the Trustee and SIPC do not hold, as they would have it, that by virtue of Section 27 *all* provisions of the 1934 Act *per se* give rise to implied private rights of action to redress violations

thereof. For example, even in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432 (1964), which did rely on Section 27, this Court stated that an implied right of action was available because it was "necessary" in order to achieve the purposes of Section 14(a). *See* Comment, *Implying Private Causes of Action From Federal Statutes: Amtrak and Cort Apply the Brakes,* 17 B.C. INDUST. & COM. L. REV. 53, 56 and cases cited in n.32 (1975) (criticizing discussion in *Borak* of Section 27 and noting that "the Supreme Court itself has almost always interpreted *Borak* as standing for an alternative principle [of necessity], without giving mention to the section 27 holding"). Similarly, this Court recently stated in *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25, that its decisions hold only "that *in some circumstances* a private cause of action can be implied with respect to the 1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies", *viz.,* only in circumstances "where congressional purposes are likely to be undermined absent private enforcement" (emphasis added). *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477; *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975). As pointed out in *Bell* v. *Hood,* 327 U.S. 678 (1946), a provision such as Section 27 only grants jurisdiction to determine *whether* an implied federal right of action exists. The reliance by the Trustee and SIPC (Tr. Br. 26; SIPC Br. 54) on *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282 (1940), also is misplaced, because "all that the *Deckert* case stands for . . . is that historic equity jurisprudence gives the federal courts very broad authority to grant relief that is ancillary to an action expressly created". 5 L. LOSS, SECURITIES REGULATION 2882 (2d ed. Supp. 1969) (also criticizing discussion in *Borak* of Section 27).

2. THE "STATUTORY TORT" THEORY IS INAPPOSITE HERE BECAUSE NO LEGAL RIGHTS OF BROKERAGE FIRM CUSTOMERS ARE INVADED BY REASON OF MISSTATEMENTS IN SECTION 17(a) REPORTS.—The Trustee and SIPC put great emphasis on a superficial and uncritical exposition of the purported "historical development" of the "statutory tort" theory, an exposition purportedly designed to establish the premise that—under "longstanding doctrine" said to originate "in English jurisprudence" going back to I COMYNS' DIGEST 248 (1762), as quoted in *Texas & Pacific Ry. Co.* v. *Rigsby,* 241 U.S. 33, 39 (1916)—the violation of a statute gives rise "in every case" to an implied right of action on behalf of persons for whose benefit it was enacted (SIPC Br. 22-23; *see also* Tr. Br. 25-30). The error of that simplistic approach both as a matter of history and of policy was demonstrated long ago. *See* 2 F. HARPER & F. JAMES, THE LAW OF TORTS 995 (1956) ("modern cases in this country make little use of the discredited reasoning"); Thayer, *Public Wrong and Private Action,* 27 HARV. L. REV. 317, 331-332 (1914); Note, *The Use of Criminal Statutes in the Creation of New Torts,* 48 COLUM. L. REV. 456, 457 and n.9 (1948). *See also* 5 L. LOSS, SECURITIES REGULATION, *supra,* at 2883-2885.[9] More significantly, the doctrine is limited by the

[9] As part of its exposition of the "historical development" of the implied rights doctrine, SIPC states that "*Hawkins* v. *Merrill Lynch, Pierce, Fenner & Beane,* 85 F. Supp. 104 (W.D. Ark. 1949), . . . recognized a private right of action under Section 17(a) and Rule 17a-5" (SIPC Br. 23). Actually, *Hawkins* did not discuss the question of implied rights of action with respect to Section 17(a) in particular, and did not hold that there was an implied right of action for violation of Section 17(a). *Hawkins* did assume that any provision of the 1934 Act would give rise to an implied remedy, but appears to have reached that conclusion because "the defendants . . . do not contend to the contrary". *Id.* at 121. One of several violations (including violations of Section 10(b) and Rule 10b-5) for which defendant was held liable as a "controlling person", however, was its correspondent's failure to file any Rule 17a-5 report. *Id.* at 124. Even assuming the doubtful proposition that *Hawkins* is correct, it is distinguishable. In

principles of statutory construction emphasized in *Amtrak* and *Barbour* (*see* pp. 9-15, *supra*), and recognized in *Cort* v. *Ash, supra,* 422 U.S. at 78. *See Ash* v. *Cort,* 496 F.2d 416, 426-429 (3d Cir. 1974) (Aldisert, J., dissenting), *rev'd,* 422 U.S. 66 (1975). *See also* Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication,* 123 U. PA. L. REV. 1392, 1394 (1975) ("[T]his early test, if literally applied, would support implication in almost every federal statute . . . . Such a test does not consider whether an implied action would disparage potentially conflicting goals, nor does it require a court to examine the effectiveness of the existing enforcement scheme and, therefore, the need for private actions").

Even aside from the limitations emphasized in *Amtrak* and *Barbour* (which in any event control here), it is doubtful that brokerage firm customers ever can satisfy what the Trustee and SIPC concede is "the principal element of the classic statutory tort doctrine" (SIPC Br. 27), *viz.,* the requirement that they be members of "the class for whose especial benefit the statute was enacted" (a requirement which is also the first *Cort* v. *Ash* factor).

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the first place, *Hawkins,* which was an action against a brokerage firm rather than accountants, involved plaintiffs whose securities were converted and who satisfied the purchaser-seller requirement. Second, a brokerage firm's failure to file a report is a different violation from filing a misleading report, and is a violation for which there is no express remedy (since Section 18(a) applies only to misstatements in reports actually filed). Thus, while Section 18(a) would preclude any implied remedy for misstatements, it conceivably might not preclude an implied remedy for the failure to file any report at all. *See Kerber* v. *Kakos,* 383 F.Supp. 625 (N.D. Ill. 1974) (purchaser had implied right of action for issuer's failure to file Section 12(g) registration statement); *Myers* v. *American Leisure Time Enterprises, Inc.,* 402 F.Supp. 213, 215 (S.D.N.Y. 1975) (Section 18(a) remedy precluded any implied remedy for non-purchaser-seller "where the alleged violation of section 13(d) concerns not the failure to file the required reports but rather the filing of reports containing false or misleading statements or omissions"), *aff'd by oral opinion,* 538 F.2d 312 (2d Cir. 1976).

As already shown (pp. 7-8, *supra*), the language of Section 17(a) and the legislative history of the 1934 Act provide no support for the argument that Section 17(a) was enacted for the "especial benefit" of customers.

In *Cort* v. *Ash, supra,* the Court explained the "especial benefit" requirement in terms of whether there is "a clearly articulated federal right in the plaintiff . . . or a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard". 422 U.S. at 82. *See also J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433, *quoting Bell* v. *Hood, supra,* 327 U.S. at 684 (recognizing propriety of implication of right of action "where legal rights have been invaded") (quoted at Tr. Br. 26; SIPC Br. 51, 53). Unlike the proxy requirements involved in *Borak* (which, as shown by explicit legislative history, "stemmed from the congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange' "—377 U.S. at 431), and the requirements of the Fourth Amendment involved in *Bell* v. *Hood* and *Bivens* v. *Six Unknown Named Agents,* 403 U.S. 388 (1971), the reporting requirements of Section 17(a) have as their basic purpose the providing of information to the SEC and other regulatory agencies rather than to customers (*see* T. R. Br. 21-23, 63-64; pp. 6-8 and n.4, *supra*) and thus cannot be said to confer any legal rights upon the customers. As stated by the District Court, Section 17(a) was "not [designed] to create any rights in anybody" and "[t]here is no such 'pervasive legislative scheme' [as there was between the plaintiff class and the defendant class in *Borak*] in the case at bar" (A. 177, A. 182).

C. The Trustee And SIPC Err In Contending That An Implied Private Right Of Action Under Section 17(a) Is "Necessary".

In arguing that an implied private right of action under Section 17(a) is "necessary" (SIPC Br. 8-16, 42-50), the Trustee and SIPC not only improperly fail to acknowledge the overall scheme of "protections" for brokerage firm customers actually established by Congress (*see* pp. 10-12, *supra*), but also make two other basic errors: (i) they overstate the importance of the once-a-year audits of Section 17(a) reports performed by independent accountants, and (ii) they misstate the position of Touche Ross as to the scope of the appropriate state law remedies available to brokerage firm customers for accountants' malpractice.[10]

[10] SIPC attempts to dilute into meaninglessness the "necessity" requirement by arguing that an implied remedy need not be indispensable, but need only "aid" or "supplement" the Congressional goals (SIPC Br. 46-47). As pointed out by Touche Ross (T. R. Br. 59-60), SIPC's interpretation of "necessity" is incorrect and would license unbridled judicial legislation. *See* Comment, *Implying Private Causes of Action From Federal Statutes: Amtrak and Cort Apply the Brakes,* 17 B.C. INDUST. & COM. L. REV. 53, 58 (1975) (noting that "implying remedies where necessary to *effectuate* the congressional purpose is distinctly different from implying remedies where they might *enhance* the congressional purpose" and that "it is this [latter] type of free-wheeling approach to implied remedies which *Amtrak* was intended to preclude"); Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication,* 123 U. PA. L. REV. 1392, 1427 ("The implication of *any* consistent remedy, however, renders useless the criterion that there be a need for such a remedy to accomplish the act's goals adequately. If Congress designs an enforcement scheme that proves effective in accomplishing the statutory goals, there is no reason to supplement that system simply because the supplemental remedy is consistent with the statute"); Climan, *Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934,* 63 CORNELL L. REV. 206, 267 (1978) ("the Court's language [in *Piper*] represents a radical departure from *Borak*'s view of the courts as roving enforcers").

1. THE TRUSTEE AND SIPC OVERSTATE THE IMPORTANCE OF THE SECTION 17(a) REPORTS INVOLVED HERE. —As already noted (pp. 12-15, *supra*), acceptance of the basic premise of the Trustee and SIPC that accountants' "certifications of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule" (SIPC Br. 16) would undermine the statutory goal of requiring continuing inspections and monitoring by SIPC, the SEC and the self-regulatory organizations. That premise also is erroneous for the more basic reason that it overstates the importance of the Section 17(a) reports involved here. The Trustee and SIPC mislead in stating that "Congress considered, but ultimately rejected, requiring the government itself to audit SEC filings" and "[i]nstead, . . . chose to have such filings audited by independent public accountants", *citing* SEC Accounting Series Release No. 81 (Dec. 11, 1958), *reprinted in* 5 FED. SEC. L. REP. (CCH) ¶72,103 (SIPC Br. 14). The cited release discusses the fact that Congress chose not to have *registration statements filed pursuant to the 1933 Act* audited by government accountants, because "it was deemed essential to refrain from placing upon any Federal agency the duty of passing judgment upon the soundness of any security". *Id.* at 62,230. That consideration has nothing whatever to do with Section 17(a) of the 1934 Act, which expressly authorizes examinations by the SEC, and it is erroneous for the Trustee and SIPC to suggest that in 1934 Congress in any way recognized a need for Section 17(a) reports audited by a broker's independent accountants. The legislative history of Section 17(a) (which is referred to at T. R. Br. 46-47, and at pp. 7-8, *supra*) focused almost exclusively on examinations to be performed by the SEC pursuant thereto and upon the cost of such examinations.

Moreover, Congress knew in 1934 that the SEC's burden in examining brokerage firms for compliance with financial responsibility rules and bookkeeping requirements would be lightened by examinations conducted by the Exchange of its members' financial questionnaires (*see* T. R. Br. 65 n.40). *See Hearings on H. R. 7852 and H. R. 8720 Before the House Comm. on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. 164-172, 189-190 (1934) (testimony regarding financial questionnaire requirement adopted by the Exchange in 1922 and separate independent audits conducted by the Exchange's accountants).

The Trustee and SIPC also seek to bolster the erroneous premise that the once-a-year audits of Section 17(a) reports are the SEC's exclusive means, as opposed to being merely just one aspect of the SEC's program, to enforce financial responsibility and other rules, by the misleading statement that "[p]rior to the adoption of the rule, the SEC noted that customer protection against the risk involved in leaving securities with broker-dealers would be increased by Rule 17a-5", *citing National Ass'n of Securities Dealers,* 12 S.E.C. 322, 329 n.9 (1942) (SIPC Br. 9, *see also* 28-29). In fact, what the SEC there stated was that protection of certain customers "will be increased by the requirements of our proposed Rule X-17A-5 *plus an exercise of the visitorial powers of the S.E.C., the NASD and others possessing similar powers*" (emphasis added). *Id.*

It also is misleading for the Trustee and SIPC to suggest that the Section 17(a) reports involved here "constitute an 'early warning system' which is designed to detect the financial unsoundness of broker-dealers at the earliest possible moment" (SIPC Br. 16). In fact, the phrase "early warning system" refers to other rules and procedures that were adopted after it had become apparent that the once-a-year audits did not provide information on a sufficiently timely and continuous basis and that there was a need for more close and continuing supervision by the SEC and other regulatory authorities. As the SEC itself explained,

> "Those techniques which had functioned well for regulatory purposes faltered heavily in the 1969-70 climate and the need for an early warning system became apparent. This may be explained as follows. First, the relatively leisurely pace of the annual reporting requirements and the consequent follow up of regulatory activity could not meet the needs of the kinetics which prevailed in the industry beginning in 1967. With the books and records of some brokers and dealers in the poor condition they were at the time, the problem for the auditors became a highly complex and laborious one." STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 91-231, 92d Cong., 1st Sess. 25, *see also* 26, 31, 39-41 (1971).

Thus, the Section 17(a) reports, though important, are simply one of the numerous means by which the SEC and other regulatory authorities attempt to obtain information for use in performing their regulatory tasks.

2. THE TRUSTEE AND SIPC MISSTATE TOUCHE ROSS' POSITION AS TO THE SCOPE OF THE APPROPRIATE STATE LAW REMEDIES.—Touche Ross has not argued, as the Trustee and SIPC erroneously state, "that state law remedies are appropriate . . . because they afford virtually complete immunity to accountants against customers' claims" (Tr. Br. 15, *see also* 32). In fact, Touche Ross has recognized that under New York law customers may recover for fraud on the part of accountants. *See Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 191, 174 N.E. 441,

449 (1931); *State Street Trust Co.* v. *Ernst,* 278 N.Y. 104, 112, 15 N.E.2d 416, 419 (1938); *cf. William Iselin & Co., Inc. v. Muhlstock, Elowitz & Co.,* 52 A.D.2d 540, 382 N.Y.S.2d 83 (1st Dep't 1976). Moreover, there are no significant variations among the laws of the various States in this regard; as Judge Mulligan stated, "should the actionable elements of fraud be provable, the States have universally permitted recovery to third parties who relied on the misrepresentations" (A. 220). Thus, unlike the proxy rules involved in *Borak,* which imposed requirements unknown to State common law, accountants' fraud and malpractice long have been a concern of State law, which supplies appropriate remedies therefor.

D. The Trustee And SIPC Err In Their Purported *Cort* v. *Ash* Analysis.

Even if *Cort* v. *Ash* were assumed to provide the appropriate analysis here (*but see* T. R. Br. 39-40, 54-55, 66-67), the purported analysis set forth by the Trustee and SIPC (SIPC Br. 26-52) is erroneous.

1. As already shown, the language and legislative history of Section 17(a) do not support the contention of the Trustee and SIPC that Section 17(a) was enacted for the "especial benefit" of brokerage firm customers, and the reporting requirements of Section 17(a) do not "create a federal right in favor of the plaintiff[s]" here (*see* pp. 6-8, 22-23, *supra*). Moreover, the carefully limited express remedy in Section 18(a) for misstatements in required reports, which is applicable to Section 17(a), reflects a Congressional intent that brokerage firm customers are not to derive any substantive legal rights or remedies from the reporting requirements of Section 17(a) (*see* pp. 6, 9, *supra*).

2. The express remedy of Section 18(a), together with the absence of any clear contrary evidence of legislative intent to permit a broader, additional implied remedy, reflects a legislative intent to deny such an implied remedy (*see* pp. 9-10, *supra*). The non-existence of any damage remedy for brokerage firm customers under the 1934 Act was *explicitly* recognized by Congress in enacting SIPA in 1970, and Congress clearly intended to fill that void not by providing such a damage remedy, but instead by enacting SIPA and creating SIPC to provide to such customers the additional financial protection that it thought appropriate (*see* pp. 11-12, *supra*).

3. It would not be "consistent with the underlying purposes of the legislative scheme" to accept the argument of the Trustee and SIPC that the regulatory authorities (upon which the 1934 Act and SIPA expressly place the pertinent inspection and monitoring duties) are not themselves to perform virtually all of those duties, and to hold accountants liable for their failure to detect such problems on the theory that Section 17(a) implicitly imposes those duties on them (*see* pp. 12-15, *supra*). The argument of the Trustee and SIPC to the contrary magnifies out of all proportion the responsibilities of the accountants and the importance of the Section 17(a) reports involved here (*see* pp. 25-27, *supra*). Moreover, it would frustrate the salutary purposes of the purchaser-seller limitation on express damage remedies embodied in the legislative scheme to permit the type of speculative claim asserted here (*see* pp. 16-17, *supra*).

4. Accountants' malpractice traditionally has been a concern of State law, which affords appropriate remedies, "so that it would be inappropriate to infer a cause of action based solely on federal law". The argument of the Trustee and SIPC to the contrary misstates the scope of the appropriate State law remedies and Touche Ross' position with respect thereto (*see* pp. 27-28, *supra*).

II

The Trustee And SIPC Err In Arguing That Section 17(a) Imposes Duties Upon Accountants, And That A Private Right Of Action May Be Implied In The Absence Of *Scienter*

A. The Trustee And SIPC Err In Contending That Section 17(a) Imposes Duties On Accountants Such As Touche Ross.

The Trustee and SIPC argue that Section 17(a) and Rule 17a-5 impose duties upon accountants, and that an implied private right of action under Section 17(a) should exist not only against the broker-dealers subject thereto, but also against accountants such as Touche Ross (*see* Tr. Br. 6-8, 27; SIPC Br. 11-16, 30-31). The Trustee and SIPC do not dispute that the language of Section 17(a) does not refer to, and does not expressly purport to impose any duty upon, accountants who have audited and expressed an opinion concerning financial reports filed pursuant thereto. Nor do they cite any concurrent legislative history which supports their contention that Section 17(a) was directed at accountants. They rely solely on Rule 17a-5, contending that it gives rise to duties manifestly not inherent in the words of Section 17(a) itself.[11]

[11] SIPC also purports to find recognition of a "duty" placed on accountants by distorting an article by Mr. Weinstein, who is a partner in Touche Ross (*see* SIPC Br. 15-16). Mr. Weinstein's article in fact emphasized (in passages that SIPC conveniently fails to quote) that "every instance of management fraud cannot be detected", that accountants "cannot be scapegoats", that the "public must mature and temper its expectations" as to what can be expected from accountants, and that "[t]he public is not served by having [the accounting] profession exposed to unlimited and unbearable liability". Weinstein, *A Time of Travail and Challenge,* 44 CPA J. 29, 30 (Dec. 1974). SIPC similarly distorts and takes out of context a prefatory statement in an AICPA publication, AUDIT OF BROKERS AND DEALERS IN SECURITIES (1977), to suggest that the AICPA has "recognized" accountants' alleged duty under Rule 17a-5 (SIPC Br. 15). The actual position of the AICPA is set forth in its *amicus curiae* brief in this case.

However, Rule 17a-5 does not give rise to any such duties. By its own terms, it is expressly limited to broker-dealers and imposes upon them alone the duty of filing reports (together with any concomitant duty to prepare them accurately). *See* Rule 17a-5(a), 17 C.F.R. §240.17a-5(a)(1972). Subdivisions (g), (h) and (i) of Rule 17a-5 (*cited at* Tr. Br. 6-8, 27; SIPC Br. 12-13), relate to the accountant's "certificate" which must be obtained by a broker-dealer and filed with its Section 17(a) reports. Those subdivisions do not purport to impose duties upon an accountant. They direct the broker-dealer to obtain a certificate stating the scope of the audit conducted, "whether" it was made in accordance with generally accepted auditing standards, "whether" it omitted any necessary procedure, what opinion the accountant reached about the financial report of the broker-dealer and what exceptions, if any, the accountant took to it. The requirements of subdivisions (g), (h) and (i) are, like the whole of Rule 17a-5, expressly addressed to the broker-dealer filing the report, and they enunciate the broker-dealer's duty to obtain an appropriate certificate, not any duty of the accountant.

Just as Rule 10b-5 must be construed in a manner consistent with Section 10(b) of the 1934 Act, *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 212-214 (1976); *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 472, Rule 17a-5 must be construed in a manner consistent with Section 17(a), which only authorizes the SEC to impose its record-keeping and reporting requirements on certain persons, including broker-dealers, but not on accountants. As *Hochfelder* states,

> "*The rulemaking power* granted to an administrative agency charged with the administration of a federal statute *is not the power to make law.* Rather, it is "'the

> power to adopt regulations to carry into effect the will of Congress as expressed by the statute.'" . . . Thus, despite the broad view of the Rule advanced by the Commission in this case, *its scope cannot exceed the power granted the Commission by Congress"* (emphasis added). 425 U.S. at 213-214.

A similar understanding is reflected in the Senate report on the 1934 Act, which observes that while "considerable latitude is allowed for the exercise of administrative discretion", nevertheless *"well defined limits* must be indicated within which the authority of such administrative authority may be exercised" (emphasis added). S. REP. No. 792, 73d Cong., 2d Sess. 5 (1934).[12]

The proposition asserted by the Trustee and SIPC "that rules *properly* promulgated by a government agency pursuant to a congressional enabling mandate 'have the force of law' ", and that such rules " 'supplement the statute' under which they were promulgated" and "may provide 'the basis for imposition of liability'" (emphasis added) (SIPC Br. at 31), and the cases they cite for that proposition, are not relevant. Neither that proposition nor any of those cases purports to authorize an administrative agency to impose by rule liabilities and duties upon a class of persons not contemplated by the enabling statute.[13]

[12] It is to be noted that whatever rule-making power may be conferred by present Section 17(e) of the 1934 Act, 15 U.S.C. §78q(e), which expressly empowers the SEC to "prescribe the form and content of financial statements filed pursuant to this title and the accounting principles and accounting standards used in their preparation", and which was enacted as part of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, §14, 89 Stat. 137 (1975), was not available in 1972. *Cf. Rothstein* v. *Seidman & Seidman,* 410 F.Supp. 244, 249 (S.D.N.Y. 1976).

[13] SIPC's contention that "not even Touche Ross argues that, in promulgating the rule, the SEC exceeded the power congressionally delegated to it by the section" (SIPC Br. 31 n.30) misses the point. While the SEC has properly required broker-dealers to file reports certified by independent accountants, it cannot properly thereby attempt to impose any liabilities and duties upon the accountants who are retained by the broker-dealers.

B. The Trustee And SIPC Err In Contending That Section 17(a) Creates An Implied Private Right Of Action In The Absence Of *Scienter.*

The Trustee and SIPC offer no reasoning beyond their own bald conclusion for creating an implied private right of action under Section 17(a) for accountants' *negligence* (*see* Tr. Br. 51-52). They overlook this Court's reasoning in *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 210, that it would "nullify the effectiveness of the carefully drawn procedural restrictions" on the express civil remedies for negligent conduct in the securities laws to permit implied actions in the absence of *scienter* (*see* T. R. Br. 80-81). They also overlook *Hochfelder's* explicit recognition of the significance of the fact that the original proposed version of Section 18(a) would have imposed liability for negligence, and that Section 18(a) was thereafter intentionally changed in subsequent bill drafts so as to eliminate liability for negligence (*see* T. R. Br. 81-82).

The procedural argument of the Trustee and SIPC for avoiding the *scienter* issue has no merit. The issue was briefed and argued in both the District Court and the Court of Appeals. Moreover, the issue properly was raised in Touche Ross' Petition for a Writ of Certiorari. Since liability may not be imposed for negligence under Section 18(a), creation of an implied right of action for negligence under Section 17(a) would mean that "the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)" (*see* the first question presented in Touche Ross' Petition for a Writ of Certiorari). The *scienter* issue therefore is one of the subsidiary questions "fairly comprised" within the Petition. *See* Rev.R.Sup.Ct. 40(d)(1)("The statement of a question presented will be deemed to include every subsidiary question fairly comprised therein"); *Procunier* v. *Navarette,* 434 U.S. 555, 559-560 n.6 (1978).

III

The Trustee Errs In Arguing That He May Assert Implied Section 17(a) Rights Of Action Of Weis Customers Whose Property He Has Been Unable To Return

The Trustee asserts that the "key" to understanding his purported right to assert implied Section 17(a) rights of certain Weis customers is his contention "that the Trustee's Section 17 claims are for damages to a specific and separate fund of customer property, not for damages . . . to any property deemed part of Weis' assets" (Tr. Br. 52). In other words, argues the Trustee, he may assert those rights because he seeks damages not with respect to interests of the *bailee* Weis, but instead with respect to interests and on behalf of the *bailor* customers. However, the Trustee's distinction is completely inconsistent with the underlying rationale of the theory upon which he premises his purported right to recover (*viz.*, the theory that the Trustee, as Weis' successor, is a bailee of customer property), and only demonstrates that the Trustee's reliance on a bailment theory is misplaced.

The Trustee has the law of bailment backwards. Thus, his basic error is his failure to acknowledge that the common law of bailment upon which he relies (but which in any event is not applicable here for the reasons set forth at T. R. Br. 91-94) permits a bailee to recover precisely because it does "deem" the bailed property to be part of the *bailee's* assets (*see* T. R. Br. 86-91). The Trustee thus completely ignores, and does not even attempt to (because he cannot) refute, Touche Ross' demonstration that the basis of the bailee's right to recover is *his own* possessory interest, that his recovery is permitted solely on the theory that "the wrongdoer . . . must treat the possessor as the owner of the goods *for all purposes*", and

that "[t]he chattel that has been converted or damaged is *deemed to be the chattel of the possessor and of no other*" (emphasis added). *The Winkfield,* [1902] P. 42, 54-55, 60 (C.A.).

The right of a bailee to sue is not derived, either logically or historically, from any theory that the bailee asserts the personal rights of the bailor as the bailor's legal representative. The Trustee's contrary assertion, which is based on misinterpretation of ambiguous *dicta* taken out of context, is clearly erroneous.[14] Moreover, the Trustee confuses the *measure* of a bailee's permissible recovery (which is the full value of the property rather than the pecuniary loss actually suffered by the bailee) with the *basis* for permitting the recovery (which is that the property is treated as if it were the bailee's own property, and not that the bailee is allowed to assert the personal rights of the true owner) (*see* Tr. Br. 56).

Touche Ross' argument is not in any way "contradicted" by—but instead is entirely consistent with and required by the logic of—the "three elementary principles of bailment law" cited by the Trustee.[15] *First,* the principle that a recovery by the bailee is a bar to a subsequent recovery by the bailor for the same injury to the bailed

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[14] The unreliable nature of the Trustee's authorities is exemplified by his citation of, and extensive quotation from, *Baldwin* v. *Hill,* 315 F.2d 738, 742 (6th Cir. 1963) (Tr. Br. 57). What the Trustee fails to reveal is that *Baldwin* v. *Hill* does not hold that a bailee may sue third parties on claims belonging to the owner and as the owner's legal representative, but rather that under the Michigan automobile "guest passenger statute" a bailee-passenger is to be considered as the "host" (that is, the "owner") rather than as a "guest".

[15] The Trustee states his "three elementary principles" as follows: "(1) either the bailor or bailee can bring an action for the same injury to the bailed property, and a recovery by one is a bar to a subsequent recovery by the other; (2) a bailee can sue for a full recovery beyond the extent of its own direct harm and regardless of any pre-existing liability it might have to the bailor; and (3) the bailee holds such recovery in trust for the bailor" (Tr. Br. 58).

property is entirely consistent with the underlying theory that the property is treated as if it were the bailee's own property, and does not require any conclusion that the bailee may assert the personal rights of the bailor. It is neither a premise nor a corollary of that principle that the personal rights of the bailee and the bailor must be equated. As shown by Touche Ross (T. R. Br. 90), there are other well-recognized situations in which the bailor may be able to recover even though the bailee cannot. *Second,* the principle that a bailee can sue for a full recovery beyond the extent of his own direct harm and regardless of whether he has any liability to the bailor also is based on the theory that the property is treated as though it belonged to the bailee alone—as was squarely held in the seminal case, *The Winkfield, supra.* That principle is in no way based upon any theory, and does not require any inference, that the bailee is asserting the bailor's personal rights. The bailee's freedom from liability to the bailor does not limit his right to recover precisely because the law is unconcerned, insofar as the wrongdoer is implicated, with who the true owner really is and what his personal rights are (*see* T. R. Br. 90-91). Indeed, as Touche Ross has noted (T. R. Br. 94 n.52), the traditional doctrine has been criticized for permitting the bailee to recover without the consent of the true owner for the very reason that, in steadfastly pursuing its fiction that the bailee is to be treated as though he actually owned the property in order to provide him a basis to assert possessory remedies, it may be unduly callous towards the interests of the true owner. *Third,* the principle that a bailee holds any recovery in excess of his own damages in trust for the bailor is not based upon and provides no basis for the Trustee's argument that the bailee may sue as the bailor's legal representative (*see* T. R. Br. 88-89 n.50 and authorities there cited). The bailee's duty to account

arises only *as a consequence* of his recovery in his own right, *and only if there is such a recovery.* The basis of the duty is the theory that the recovery takes the place of the property and that it would unjustly enrich the bailee to permit him to retain the proceeds of the property even though he otherwise might have no liability to the bailor for the loss thereof. But the duty to account for any recovery does not create or enhance the bailee's right to recover. Neither logic nor any valid policy permits the bailee to infer from the consequential duty to account to the bailor (the only predicate for which is the fact of recovery) any right to assert as against the wrongdoer any of the bailor's personal rights simply in order to create a recovery (*res*) as to which such a duty to account could attach. Simply put, the bailee's duty to account to the bailor, and the fact that the bailor might thereby obtain the proceeds of any recovery by the bailee, are "immaterial" to the question of whether the bailee has any right of action against the wrongdoer. *Berger* v. *34th St. Garage, Inc.,* 274 App.Div. 414, 420, 84 N.Y.S.2d 348, 353 (1st Dep't 1948), *mot. for leave to app. denied,* 275 App.Div. 660, 86 N.Y.S.2d 667 (1st Dep't 1949); *The Winkfield, supra,* [1902] P. at 60.

The Trustee's reliance on Rule 17(a), F.R.Civ.P., also is misplaced (Tr. Br. 57-58). Rule 17(a) has no effect on substantive rights and does not "recognize" any substantive right of a bailee to assert the personal rights of the bailor as his legal representative in contexts where substantive legal principles do not create any right of recovery in the bailee himself (*see* T. R. Br. 94-95). All that Rule 17(a) recognizes is the fact that there is no procedural obstacle to a suit by a bailee in his own name where substantive legal principles make him—and not just the bailor—"a real party in interest", *i.e.,* "[*a*] *party who, by the substantive law, has the right sought to be enforced*".

3A MOORE'S FEDERAL PRACTICE ¶17.02 at 17-13, ¶ 17.07 at 17-65 (2d ed. 1978).

Caplin v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), which holds that a trustee having powers that are in all pertinent respects the same as those of the Trustee here has no right to assert rights of action belonging to third parties (*see* T. R. Br. 96-98), is asserted by the Trustee to be distinguishable only because of the rights that he purports to have under his "bailee" theory (Tr. Br. 59). Since the "bailee" theory gives the Trustee none of those rights, *Caplin* applies here and precludes the Trustee from asserting any customer rights of action.

The Trustee errs not only in his effort to uphold the judgment of the Court of Appeals in his favor on the "bailee" question, but also in his improper attempt to overturn and modify that judgment so that he may seek a much larger recovery than the judgment provides. The Court of Appeals held that the Trustee has a claim for relief "on behalf of such customers as have not been fully reimbursed by SIPC", to "the extent that [those] customers have claims that have not been satisfied by Weis in liquidation . . . or by SIPC" (A. 202, A. 204). But the Trustee argues that if SIPC's claims as "subrogee" of customers are held to be without merit (as they should be), the Trustee also should be permitted "to sue for the damages claimed by SIPC" (*i.e.*, for an additional $14,000,000), because "[a]s between the Trustee and SIPC, it is of no importance which entity recovers this amount" (presumably because in that event the Weis estate would merely be a conduit to funnel the funds to SIPC, which is a subrogee of customer claims against the estate and particularly the single and separate fund, to the extent of its advances) (Tr. Br. 12, 52 n.17). However, the Trustee has not filed any cross-petition for certiorari

seeking that result, which would very substantially enlarge his rights under the judgment below. To permit the Trustee to seek such relief at this late juncture would violate the well-established rule, which often has been repeated by this Court, that a respondent such as the Trustee cannot seek by way of argument to overturn or modify any portion of a judgment below without filing a cross-petition for certiorari.[16] However, even if the Court were to reach the merits of the Trustee's newly-interposed claim for additional relief, such relief should be denied because no Section 17(a) right of action should be implied on behalf of customers to recover losses for which they have been compensated by SIPC (*see* T. R. Br. 77 n.45, 103-104), even if it be assumed that the Trustee may recover customers' uncompensated losses in accordance with the holding of the Court of Appeals.

IV

SIPC Errs In Arguing That It May Assert Implied Rights Of Action As Subrogee Of Weis Customers For The Payment Of Whose Claims It Has Advanced Funds To The Trustee

SIPC does not dispute that the statutory subrogation rights provided to it by Section 6(f)(1) of SIPA, 15 U.S.C. §78fff(f)(1) (1970), are limited to the "claims" of customers (for the payment of whose "claims" SIPC has advanced funds to the Trustee) *against the estate of the brokerage firm* (*i.e., the Weis estate*) (*see* T. R. Br.

[16] *See, e.g., United States* v. *Reliable Transfer Co., Inc.*, 421 U.S. 397, 401 n.2 (1975); *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 226-227 n.2 (1975); *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 61-62 n.11 (1975); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 381 n.4 (1970); *LeTulle* v. *Scofield*, 308 U.S. 415, 421-422 (1940); *Alexander* v. *Cosden Pipe Line Co.*, 290 U.S. 484, 487 (1934); *cf. Langnes* v. *Green*, 282 U.S. 531, 535-539 (1931); *Morley Construction Co.* v. *Maryland Cas. Co.*, 300 U.S. 185, 190-193 (1937).

100; SIPC Br. 57 and n.52). SIPC's arguments, by which it seeks to slip away from the unavoidable conclusion that the express subrogation provision of Section 6(f)(1) was intended by Congress to provide SIPC's exclusive subrogation rights, are without merit.

SIPC argues that Section 2 of SIPA, 15 U.S.C. § 78bbb (1970), makes SIPA an amendment to the 1934 Act, and that SIPC thereby obtains some benefit from Section 28(a) of the 1934 Act, 15 U.S.C. §78bb(a), which is intended to preserve pre-existing common law rights of investors that would exist in the absence of the 1934 Act. SIPC has no such rights, however, because it is solely a statutory creature which owes its very existence to SIPA, and because the rights that it seeks to assert here arise from and are premised upon its statutory duty to advance funds (a duty which SIPA creates and which would not even exist in the absence of SIPA). Moreover, the incorporation of SIPA into the 1934 Act was intended only for the purpose of making it clear that the rights conferred on investors by SIPA are in addition to whatever pre-existing rights the investors had under the 1934 Act, and was not intended to confer any rights on, or supplement the rights of, SIPC—as even the Court of Appeals majority recognized (A. 201 n.13).[17]

SIPC also erroneously argues that the inference that the express statutory subrogation provision is exclusive must yield to a purported "generally expressed legislative

[17] *Federal Marine Terminals, Inc.* v. *Burnside Shipping Co.*, 394 U.S. 404 (1969), which SIPC cites (SIPC Br. 59), held only that a stevedoring contractor's statutory subrogation to its deceased employee's representative's rights against third persons did not abrogate its own, pre-existing, direct common law right of action. It did not involve judicial creation of a new implied federal right of action, nor an entity such as SIPC which is a creature of the statute which creates it, nor the issue whether such an entity has subrogation rights in excess of those enumerated in the statute's express subrogation provision.

policy" to "maximize SIPC's recovery of the funds it expends" (SIPC Br. 59-61). However, the provisions of SIPA to which SIPC refers as purportedly providing implicit evidence of "legislative policy" refer only to SIPC's right to receive payments from the single and separate fund or the general estate of the debtor, and not from third parties; and SIPC overlooks the explicit legislative history which sets forth the actual Congressional intention that any recoupment by SIPC would be from the debtor's estate and not from third parties such as Touche Ross (*see* T. R. Br. 107-108).

Nor must SIPC be permitted to recoup its losses to keep Touche Ross from escaping "the legal effect of the breach of [its] pre-existing duty", as SIPC argues (SIPC Br. 60). The "duty" which SIPC seeks to impose here upon Touche Ross is a new duty, namely responsibility for the "efficacy of the 'early warning system'" and "the burden of providing customer protection" (*id.*). That duty is one which arises from SIPA and which SIPA squarely places upon SIPC (exclusively insofar as monetary liability is concerned) and the other regulatory authorities, and not upon accountants such as Touche Ross (*see* pp. 12-15, *supra*). SIPC seeks simply to shift that duty to Touche Ross. Insofar as Touche Ross' actual pre-existing duties are concerned, it remains liable in common law actions for accountants' malpractice for any breach thereof, and therefore does not receive any "windfall benefit" (*see* T. R. Br. 107).

SIPC unpersuasively responds to Touche Ross' showing (*see* T. R. Br. 102-106) that, in order to protect customers, it is unnecessary to imply a right of action under Section 17(a) on their behalf for losses for which SIPC has compensated them[18] and to grant subrogation

[18] It also is unnecessary, in order to effectuate Congress' goals, to imply a right of action on behalf of customers for losses that are not covered by SIPA protection. The SIPA limits reflect a Congressional concern to protect primarily the average investor, and a Congressional belief that large investors should be responsible personally for safeguarding their own interests. *See* 116 CONG. REC. 40872 (1970).

rights to SIPC in addition to those expressly specified in SIPA, because the only beneficiary thereof will be SIPC rather than the customers (and because the result otherwise would be inconsistent with the statutory purposes). SIPC's only response is its suggestion that if it is permitted to refill its coffers at Touche Ross' expense, it might enhance its ability to provide protection in the future to customers of other brokerage firms (SIPC Br. 60-61). That remote and speculative possibility provides no adequate basis for the judicial invention of rights that Congress did not create and liabilities that Congress did not impose. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.*, 417 U.S. 703, 715 (1974); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 254 (1951).

CONCLUSION

For the foregoing reasons, and the reasons set forth in Touche Ross' main brief, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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